CAPITAL PRESS, INC. — MIAMI, FLORIDA

in the

Supreme Court

of the

United States

OCTOBER TERM, 1975

Case No. 75-969

S. D. COHN & COMPANY and SIDNEY D. COHN,
Petitioners,

vs.

SHIRLEY WOOLF and ROBERT MILBERG, and FIBERGLASS RESOURCES CORPORATION,
Respondents.

BRIEF FOR RESPONDENTS SHIRLEY WOOLF AND ROBERT MILBERG IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS IN AND FOR THE FIFTH CIRCUIT

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A

OPINIONS BELOW

The instant Petition for a Writ of Certiorari aptly sets forth the opinions below. In this brief in opposition, the symbol "A" will refer to the appendix attached to the Petition for Certiorari, which Respondents adopt in full, and the symbol "R" will refer to the trial transcript of record.

B

GROUNDS UPON WHICH JURISDICTION OF THIS COURT IS INVOKED

The jurisdictional requisites have been properly set forth in the Petition.

C

QUESTIONS PRESENTED

WHETHER POLICY CONSIDERATIONS WHICH GOVERN SUPREME COURT REVIEW ARE PRESENT IN THE INSTANT PETITION FOR CERTIORARI.

A. WHETHER THE "CLEARLY ERRONEOUS" RULE PRECLUDES APPELLATE REVIEW WHERE JUDGMENT WAS PREDICATED UPON A MISAPPLICATION OF LEGAL PRINCIPLES.

B. WHETHER THE PETITION FOR CERTIORARI PRESENTS ISSUES OF SIGNIFICANT IMPORT TO WARRANT SUPREME COURT REVIEW.

C. WHETHER THE COURT OF APPEALS APPLIED IMPROPER STANDARDS IN REJECTING THE DEFENSE OF *IN PARI DELICTO* AS A MATTER OF LAW.

D

STATEMENT OF THE CASE

The Petition states an adequate chronology of the proceedings in the lower courts.

For purposes of this brief in opposition to the instant Petition, Respondents accept Petitioner's statement of the facts shown at trial, except to add that the trial testimony reflects that none of the substantial risks of the transaction at issue, known by Petitioners, were disclosed to Respondents.

Woolf and Milberg were never advised that Fiberglass Resources Corporation would be required to incur substantial start up expenses, as the plant to be purchased had been closed by the Koppers Company. (R-377, 379). No

disclosure was made to Respondents that the plant would be purchased upon receipt of the Pakistan contract and not upon its successful completion. (R-272). Respondents were never told that the summary of projections prepared by Fiberglass were not credible. (R-291). No disclosure was made that the business was extremely competitive, undercapitalized and inadequately financed. (R-313). No information was imparted to Respondents concerning the plant's operating results under either of its predecessor Companies. (R-275) These omissions in disclosure are taken directly from the trial testimony of Petitioner S. D. Cohn.

The facts clearly indicate that Respondents were led to believe they were investing in an ongoing business, assured of profitable operations and that they would realize a substantial profit on their investment. (R-42, 138).

In October, 1968, Woolf purchased 6¼% convertible subordinated debentures of Fiberglass for the sum of $100,000. Record ownership of the debentures was $50,000., in the name of Woolf, and $50,000., in the name of Milberg. Respondents candidly admitted at trial that five of Respondent's friends and associates held beneficial interest in the debentures. (R-157, 158).

In March of 1969, Respondents were requested to convert their debentures, on the representation by Sidney Cohn that their conversion would improve the balance sheet, better enabling Fiberglass to obtain a bank loan from the Chemical Bank of New York. No financial information on Fiberglass was imparted to Respondents to

allow them to make an informed investment decision with respect to the conversion of debentures.

The findings of the District Court and the opinion of the Fifth Circuit are set forth in the appendix and we believe no comment with respect thereto is necessary.

REASONS FOR DENYING THE WRIT

THE POLICY CONSIDERATIONS WHICH GOVERN SUPREME COURT REVIEW ARE NOT PRESENT IN THE INSTANT CAUSE AND ACCORDINGLY, JUDICIAL EFFICACY REQUIRES THE PETITION BE DENIED.

Petitioners have requested the Court to issue a Writ of Certiorari to review a decision of the Fifth Circuit Court of Appeals which was based upon sound and established judicial principles, does not raise important issues of federal law, and is not of major public concern. Respectfully, the Petition should be denied.

THE "CLEARLY ERRONEOUS" RULE DOES NOT PRECLUDE APPELLATE REVIEW WHERE JUDGMENT WAS PREDICATED UPON A MISAPPLICATION OF LEGAL PRINCIPLES.

Respondents Shirley Woolf and Robert Milberg sought recovery under Rule 10b-5 adopted pursuant to the Securities and Exchange Act of 1934, from Petitioners S. D. Cohn & Company and Sidney D. Cohn, individually, for fraud in the sale of securities. The District Court of

the Southern District of Florida entered judgment for the Defendant/Petitioners and issued, inter alia, the following conclusions of law:

> The evidence produced at trial clearly and convincingly showed that the Plaintiffs did not establish any misrepresentations or omissions of material fact knowingly committed by the Defendants and relied upon by the Plaintiffs in the relevant securities transactions, and the Defendants are not guilty of violating Section 10(b) of the Securities Exchange Act of 1934 or Rule 10b-5 issued thereunder and are not liable to the Plaintiffs. (A-66)

> Plaintiffs, sophisticated investors, have not shown the necessary degree of reliance in this case to entitle them to recovery. (A-67)

Upon appeal by Respondents, the Fifth Circuit vacated the judgment of the District Court and remanded the cause for a new trial. The Court stated:

> We need not decide here the validity of the trial court's findings of fact regarding specific misrepresentations or omissions, except to note the sharp conflict in the testimony regarding virtually every one of them. For, although 10b-5 liability could have been predicated upon the specific misrepresentations and omissions, if proved, it is still open to the Plaintiffs to prove a 10b-5 violation in this context based upon something broader. Assume that the Defendants

> failed to qualify the sale of Fiberglass debentures as exempt from registration under §4(2) of the 1933 Act, and that part of the failure was a lack of disclosure of information regarding the investment opportunity that registration would have revealed. Depending on the amount of information the Defendants failed to disclose to offerees and its materiality to the transaction, we think there comes a point where the failure to disclose can be characterized as an "act, practice or course of business which operates or would operate as a fraud or deceit" upon the offerees in violation of the third clause of the Rule. (A-38)

Petitioners have contended the Court of Appeals committed fundamental error by vacating judgment on the grounds that the "findings of fact" entered by the trial court were not determined to be "clearly erroneous". Except as to incidentally note the sharp conflicts in testimony (A-38), the Fifth Circuit did not disturb those findings of fact. Rather, The Court of Appeals found that the trial court did not apply appropriate legal standards in reaching its result. The "clearly erroneous" test set forth in Rule 52(a) Federal Rules of Civil Procedure, is not applicable where the trial court's conclusions are based on a misapprehension of applicable legal standards. *Crosby v. United States,* 5 Cir., 1974, 496 F.2d 1384; *Mitchell v. Raines,* 5 Cir., 1956, 238 F.2d 186; *Owen v. Commercial Union Fire Insurance Co. of New York,* 2 Cir., 1954, 211 F.2d 488. Specifically, the trial court failed to consider:

> the extent to which Rule 10b-5 provides a remedy to a purchaser of securities against the issuer or others involved in the distribution when the issuer and its agents failed to conduct the distribution in such a manner that it qualifies for the exemption from registration provided by §4(2) of the Securities Act of 1933, 15 U.S.C. §77d (2) (1970). (A-33).

Indeed, the District Court made no findings of fact with respect to omissions in disclosure, in spite of the trial testimony of Petitioner, Sidney Cohn that Respondents were not advised the Koppers Company had closed the plant to be purchased and that Fiberglass would therefore incur start up costs in excess of $100,000. (R-377, 379) No disclosure was made to Respondents that the factory would be purchased upon receipt of the Pakistan contract rather than upon its completion. (R-272) Petitioners omitted to disclose to Respondents that the financial projections in the summary should not be believed (R-291), and Respondents received no information relating to operation of the factory under the predecessor companies. (R-275)

We submit that if the Fifth Circuit intended to substitute its judgment of the facts for those of the trial court, it would have reversed with instructions to enter judgment for the Plaintiffs. Rather, the Court of Appeals vacated the judgment on the basis that the trial court had utilized an erroneous legal standard in viewing the facts before it. In its opinion denying the petition for rehearing[1] the court stated:

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[1]521 F.2d 225 (5 Cir., 1975).

> We wish to insure that, on remand, the District Judge will focus not so much upon specific misrepresentations that were alleged (as he did in his earlier consideration of the case), but will also be aware of the stringent disclosure requirements our Court has held necessary in the private placement context. (A-7)

The decision of the Fifth Circuit in the instant cause was dictated by the legislative and judicial history of the regulation of securities markets, and was correct. The Court applied sound and established precedent in reaching its decision and accordingly the Petition does not raise issues meriting review by this Court.

THE DECISION OF THE COURT OF APPEALS DOES NOT RAISE ISSUES OF SIGNIFICANT PUBLIC IMPORT TO WARRANT SUPREME COURT REVIEW.

The instant Petition for Certiorari has presented a strained view of the holding of the Court of Appeals, in asserting it established erroneous standards for recovery in a 10b-5 case. The Court stated:

> "Under any view of how far 10b-5 should extend, the area of private offerings of securities under the exemption afforded by §4(2) of the 1933 Act is so closely related to the fairness of the public private securities markets and the allocation of investment capital that it must come within the scope of the rule. The fact that the Plaintiffs sought relief under §10(b) of the 1934 Act for al-

leged violations of the 1933 Act does not alter this result, for, as the Second Circuit has noted, these acts are to be construed as "a single comprehensive scheme of regulation" to avoid inconsistencies and to promote their broad remedial purposes. *Globus v. Law Research Serv., Inc.*, 2d Cir. 1969, 418 F.2d 1276 (collecting authorities.)" (A-37)

The Fifth Circuit vacated the judgment of the trial court finding that the court gave no consideration to the substantial nondisclosures of record in rendering judgment for the Petitioners. The cause was remanded to allow the trial court to determine whether the cumulative effect of the omissions in disclosure were such that a reasonable investor might have considered them important in making his investment decision. (A-52) That omissions to state material facts, in the sale of securities, may constitute a violation of Rule 10b-5 cannot be disputed. The very purpose of the Rule is to prevent injury suffered as a result of those deceptive practices. *Superintendant of Ins. vs. Bankers Life and Cas. Co.*, 2 Cir. 1970, 430 F.2d 355 reversed and remanded for trial, 404 U.S. 6, 92 S.Ct. 165, 30 L. Ed. 2d 128, *Affiliated Ute Citizens of the State of Utah vs. United States*, 1972, 406 U.S. 128, 92 S.Ct. 1456 31 L.Ed. 2d 741.

The Court additionally stated that, under certain circumstances, nondisclosure incident to failing to qualify a distribution as a private offering under Section 4(2) of the Securities Act of 1933, 15 USCA §77 (d)(2) may give rise to a violation of Rule 10b-5. If that holding sets forth a novel theory for recovery in a 10b-5 action, this cause should not be its testing ground.

Firstly, the Court painstakingly noted, throughout its opinion, the absence of clarity in the record as to what information was imparted or withheld by Petitioners to Woolf and Milberg in connection with the sale of Fiberglass debentures. (A-32) However, the Court took particular note of Sidney Cohn's own testimony that many facts of which he had knowledge were not disclosed (A-50, 51)

Considerations governing review on Certiorari, as set forth in Rule 19, Supreme Court Rules, do not contemplate that the Writ will issue where the Court cannot make a determinative ruling. We suggest that the District Court must first be permitted to consider the omissions in disclosure of record, and then determine whether these omissions constitute a 10b-5 violation. This was the instruction of the Fifth Circuit. (A-52, 53).

Secondly, Petitioners state in their brief; "clearly the placement here was a private one which cannot be seriously contested, even under the Fifth Circuit views set forth in *Hill York Corp., v. American International Franchises*, 5 Cir., 1971, 448 F.2d 680."

Whether the offering qualified as a private placement has yet to be determined, and the Court followed long established principles of securities law in stating, "on remand, the burden is on the Defendants to establish the availability of the exemption." (A-39). *S.E.C. v. Ralston Purina, Co.*, 1959, 346 U.S. 119, 73 S.Ct. 981, 97 L.Ed. 1494. (A-52).

Finally, the questions of primary importance to the financial community, with respect to the inter-relationship

between the various anti-fraud provisions of the securities acts and the private placement exemption (4(2)), relate to a determinative ruling on the factors set forth in the newly adopted Rule 146,17 C.F.R. §240.146 (1974) of the Securities and Exchange Commission and the relationship between the 4(2) exemption and the non-exclusive Rule 146. We submit that this case does not provide the appropriate vehicle for the Court to determine this question.

No evidence whatsoever was offered at trial by the Petitioners as to the availability of the §4(2) exemption. Moreover, the offering at issue was made prior to the adoption of Rule 146. Questions relating to the qualification of offerees, the availability of information, the manner of the offering and the absence of redistribution are simply not present in the instant proceeding.

In a recent position paper, the securities law section of the American Bar Association states:

> As a practical matter, there is likely to be a clear connection between the factors [above] which determine whether §5 was violated and whether disclosure was adequate. That is, the more adequate, careful and painstaking the disclosure, the more likely it is that a Court will find that the §4(2) exemption applied, including the fact that there were proper and qualified offerees who could understand the risks based upon the disclosures made to them. On the other hand, the more defective the disclosure, the more likely it is, we believe, that a Court will find the transaction to be non-exempt under §4(2). *Section*

> *4(2) and Statutory Law, a Position Paper of the Federal Regulation of Securities Committee, Section of Corporation, Banking and Business Law of the American Bar Association,* the Business Lawyer; Vol. 31, Nov. 1975, p. 485, 502.

The authors noted that the Securities and Exchange Commission suggested in Release No. 5226 (Jan. 10, 1972), 1CCH Fed. Sec. L. Rep. §2785, that the anti-fraud rules are violated in a private placement if the issuer does not make certain disclosures to the purchaser, including disclosures as to non liquidity. *Id.* at 502.

In this light, it is significant to note that the Court's opinion, with respect to disclosure requisites in the area of private offerings, will have little, if any, effect on the future regulation of securities markets. The opinion of the Court on this question was based exclusively on prior Federal decisional law expounding on the disclosure necessary for an issuer to qualify a distribution as exempt from registration. The significance of these authorities, in light of Rule 146, has clearly been diminished.

If the Court is to consider the interrelationship of these statutory provisions and administrative rules, we submit the proper case for review will involve all of the factors set forth above including Rule 146, so that the public, the financial community and the securities bar will have the benefit of a definitive decision on these issues. This cannot be accomplished in the instant cause, and therefore, as no issue of public importance has been raised, the Writ should be denied.

THE COURT OF APPEALS APPLIED ESTABLISHED JUDICIAL STANDARDS IN REJECTING THE DEFENSE OF *IN PARI DELICTO* AS A MATTER OF LAW.

The Petitioners based the defense of *in pari delicto* in the Trial Court upon two false representations which were candidly admitted by the Respondents during the course of their testimony. The first occurred at the time of purchase of the Fiberglass debentures wherein Respondents, in the debenture agreement, alleged that there were no other beneficial owners and that they were purchasing the securities for investment purposes. The second representation occurred in August 1971 at which time Respondents wrote to Medney stating that there were actually twenty-two beneficial owners of the converted debentures.

Upon these facts the Trial Court entered the following conclusion of law:

> Regardless of the Defendants' guilt or innocence, under Rule 10b-5, the Plaintiffs would be precluded from recovery as a result of their own violations of Section 10(b) of the Securities Exchange Act of 1934 and 10b-5 issued thereunder in their transactions with Fiberglass Resources Corporation. The defense of *in pari delicto* is applicable to the factual situation before this Court. See *Kuehnert v. Texstar Corp.*, 412 F.2d 700 (5th Cir. 1969.) Plaintiffs rely heavily upon *Katz v. Amos Treat & Co.*, 411 F.2d 1046 (2nd Cir. 1969), and claim it cannot be distinguished from the instant case. Quite to the contrary,

> there is nothing in the evidence in the instant case to show Defendant's conduct came within a fraction of the outrageous activities of the defendant-broker in *Katz*, such as staging "a dog and pony show" at the plant of the corporation in question to assure prospective purchasers of the thriving nature of the corporation's business. In addition, *Katz* was duped and tricked at one stage after another and understandably the Second Circuit held he was not *in pari delicto* with the Defendants. On the other hand, in the instant case Plaintiff's letter of August 4, 1971, was an admittedly false bluff which caused Fiberglass to purchase Plaintiff's shares of stock. (A-67)

The Fifth Circuit rejected the finding of the Trial Court and held that the defense of *in pari delicto* did not apply to bar Respondent's from recovery, as a matter of law.

The Fifth Circuit's holding with respect to the defense was grounded upon well established judicial principles set forth in the appellate decisions cited below.

The Court specifically found that Respondent's letter to Medney of August, 1971, was wholly unrelated in time and in purpose from the alleged unlawful activity of the Petitioners, and could not be characterized as active, knowing, simultaneous or of equal participation in the primary activity which constituted the subject matter of Respondent's complaint. (A-30) *Keystone Driller Co., vs. General Excavator Co.*, 1933, 290 U.S. 240, 54 S.Ct. 146, 78 L.Ed. 293; *Kiefer-Stewart Co., vs. Seagram and*

Sons, 1951, 340 U.S. 211, 71 S.Ct. 259, 95 L.Ed. 219; *Perma Life Mufflers, Inc. vs. International Parts Co.*, 1968, 392 U.S. 134, 88 S.Ct. 1981, 20 L.Ed.2d 982. Moreover, Petitioners were not in any way affected by the admitted misrepresentation, and were not parties to the subsequent repurchase of the Fiberglass stock.

The Court further found, based on the decision of the Second Circuit in *Katz v. Amos Treat*, 1969, 411 F.2d 1046 and of the Tenth Circuit, in *Can-Am Petroleum Co., vs. Beck*, 1964 331 F.2d 371, that the representations made by Respondents in the debenture agreement could not constitute a bar to recovery as a matter of law. Those decisions presented direct precedent, in factually similar settings, and were relied upon heavily by the Fifth Circuit on the instant issue.

Petitioners assert that the Court of Appeals employed improper standards for the applicability of the defense of *in pari delicto* but present no decisions in conflict with those cited by the Court.

Whether the defense is applicable to the facts of this action is of no public consequence, nor does it meet any other jurisdictional consideration for review by this Court. After an exhaustive study of the facts, in light of the controlling authorities, the Fifth Circuit found the defense did not apply. As their decision was based upon established authority, the issue is simply not one warranting Supreme Court review.

CONCLUSION

Respectfully, the Petition for Writ of Certiorari should be denied. Petitioners have presented issues before this Court which are singularly narrow, factually ambiguous, and of minor importance to the public in general, and the securities bar in particular. If the Court passed upon a novel question of securities law concerning the disclosure requirements upon an issuer in a private placement offering, it did so without reliance on the newly adopted Rule 146, and in an action for violation of Rule 10b-5. For these reasons we suggest this case does not present a proper setting for Supreme Court review of this issue. Moreover, the Fifth Circuit properly vacated the judgment of the trial court on other grounds. Firstly, the trial court applied erroneous legal standards in concluding that Plaintiffs had failed to prove a 10b-5 violation. Secondly, the trial court improperly found the defense of *in pari delicto* barred Plaintiffs from recovery.

Respectfully submitted,

LEVINE, RECKSON & REED, P.A.
Attorneys for Petitioners

By /s/ Richard E. Reckson

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that three true copies of the Brief in Opposition to the Petition for Writ of Certiorari has been mailed this ____ day of February, 1976, to: Robert Orseck, Esquire, Attorney for Petitioners, 25 West Flagler Street, Suite 1201, Miami, Florida 33130, and to Terrence Russell, Esquire, 900 N.E. 26th Street, Ft. Lauderdale, Florida, Attorneys for Fiberglass Resources Corp., in accordance with Rule 33 of this Court.

By /s/ Richard E. Reckson